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INFORMATION MEMO

The Commission of the European Economic Community has just published its Quarterly Survey No. 3/1964 on the economic situation in the Community.

This Survey describes the main features of the Community's present economic situation: on the one hand continuing expansion, but at a rather slower pace, on the other the emergence of clearer trends towards improved economic balance. It particularly stresses the initial results of the stabilization campaign undertaken in the Community.

For the Community as a whole, and for the different Member States in particular, the Survey also examines the outlook for the coming months and studies the short-term economic policy problems which arise in this context.

The first report from the Commission to the Council, dated July 20, 1964, on action taken by the Member States on the Council's recommendation of April 14, 1964, and the opinion rendered on July 15, 1964 by the Short-term Economic Policy Committee concerning the preliminary economic budgets for 1965, are published as annexes.

As regards the overall situation the Commission notes that external demand did not increase quite as rapidly as in the first quarter. Nevertheless, on the basis of foreign trade statistics, the value of goods exported to non-member countries during the second quarter was 9% above the corresponding figure in 1963. This reflects not only the expansion of the world economy, which continues in general to be quite vigorous, but also certain effects which the easing in the expansion of internal demand has had on the development of exports.

On the whole the expansion of internal demand in money terms lost something of its momentum in the Community as a whole.

Although investment picked up considerably in the Federal Republic of Germany, investment expenditure in the Community increased less quickly than in the first quarter, owing to a clear decline in Italy. In most member countries expenditure on building and construction, which had risen very rapidly in the first quarter as a result of good weather, could not maintain the same high rate of growth.

Investment in stocks again increased considerably in all Community countries, mainly because of a greater tendency to stock raw materials and semi-manufactures and because of good harvests.

Expenditure on consumption rose markedly, but here too the pace was lower than in the first quarter. Particularly in Italy there was a distinct slowing down in the rate of expansion, but this was also true of France; in the Netherlands there was an unmistakable drop in the rate of expansion of private consumers' expenditure after the very sharp rise experienced in the first quarter. There was, it is true, some quickening of the pace in Germany, but this was not sufficient to offset the effects at Community level of these developments in other member countries.

Apart from agricultural production (harvests should in general be well above last year's), internal supply also tended to grow less rapidly. This applies to industrial production in particular, partly because of increasing inelasticity in some industries and some countries - here manpower shortages played an important role - and partly because of falling demand in others. However, the index of industrial production published by the Statistical Office of the European Communities shows a 6% rise on the second quarter of 1963.

Strains on the labour market continued, except in France, where certain signs of relief could be seen in some areas and sectors, and Italy, where there may even have been a certain decline in the total number of hours worked.

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The upward trend of Community imports from non-member countries lost something of its momentum, though imports of goods into Germany increased more rapidly, while imports to Italy fell sharply. According to customs returns, the aggregate value of Community imports of goods during the second quarter was 10% higher than in the corresponding period of 1963.

The beginnings of a return to economic equilibrium were most clearly visible in trade between the member countries, where expansion was rather slower. Italy's balance in particular improved considerably, and there was an appreciable decline in Germany's surplus. On the basis of imports as shown in customs returns, the total value of intra-Community trade in the second quarter was 17% higher than in the second quarter of 1963.

Price increases, however, continued. The consumer price indices show that in Italy they were for a time even more rapid than before, and in Belgium too prices rose faster than hitherto. In the other member countries prices did indeed go up, but the increase was moderate - especially in France. In part the tendency for prices in the Community to be pushed up was due to special factors, such as dry weather and storms in some areas and higher charges by public undertakings.

The Community's balance of trade with the rest of the world did not deteriorate in the second quarter (largely owing to a notable improvement in Italy's balance), but the deficit was still \$146 million bigger than a year earlier. Member countries' official gold and foreign exchange reserves rose \$320 million between the end of the first and second quarters, but at the same time the net foreign exchange holdings of the commercial banks probably fell even more.

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Everything points to continuing expansion in the Community as a whole up to the end of the year, but the increases in external demand, internal demand and production may again slow down somewhat. Particularly in Italy, the expansion of domestic demand will still be decidedly weak. However, the Commission currently forecasts that for 1964 as a whole the increase in the real gross product of the Community may well be 5.5%.

Preliminary forecasts for 1965 indicate that economic expansion in the Community will continue. The growth rate during the year may be rather slower than in 1964 - particularly the first half of 1964. Nevertheless, the growth of GNP for the full year should be at least 4%.

The world economic situation will probably not favour expansion quite as much as it did in 1964. Internal demand in money terms may also be slowed down not a little in the Community by the effects of stabilization measures. This is likely to have a favourable effect on foreign trade balances and, perhaps to an increasing extent, on prices, and at the same time it will doubtless contribute to a certain moderation of the pace of real economic growth.

The situation will, however, still tend to vary from country to country: a further vigorous rise of domestic demand together with reduced elasticity of domestic supply in Germany, entailing the possibility of increased prices: persistence of the strains being felt in Belgium - though possibly in milder form; relatively slow growth of demand in France and the Netherlands, with some repercussions on the growth of production; possibly some increase in business activity in Italy, relatively slight at first; and in general, persistence of the upward pressures on prices, though in most member countries less marked than in 1963 and 1964.

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Finally the Commission is of the opinion that the tendencies sketched above may still be altered considerably through economic measures. It is important that these should be directed more than has hitherto been the case towards the stabilization of prices and costs and that pressure should not be put on investment alone, as has sometimes happened in the past - especially in Italy. On the whole, then, a continuation of anti-inflationary action, in line with the Council's recommendations of April 14, 1964, seems to be called for if complete equilibrium is not only to be achieved in the first six months of 1965 at the latest, but to be made safe for the future. Only in Italy does it seem that a policy whose general effect is to slow down internal demand in money terms is no longer suitable. The "mixture as before" should be modified in such a way as to limit the increase in costs and encourage investment.